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Volcker Delay a Plus for Munis.

WASHINGTON – The Federal Reserve Board's decision to delay certain aspects of the Volcker Rule are a plus for the municipal market, a major rating agency and a dealer group said.

The Fed decided earlier this month to delay until July 21, 2017 implementation of Dodd-Frank Act provisions that would prevent banks and their affiliates from gambling federally-insured money in risky funds. The municipal market has been preparing for a major change to the roughly $70 billion to$80 billion tender-option bond market. But Moody's Investors Service said this week the Fed's decision will delay a mass liquidation of bonds associated with TOB programs.

The deadline was originally in July of this year.

Under Volcker, banks will no longer be able to sponsor a TOB program, own a residual certificate issued by a TOB trust, or provide credit enhancement, liquidity, or remarketing services to these programs. TOB programs have historically been used to provide short-term, tax-exempt munis to money market funds. In a typical TOB program, the sponsor will deposit a fixed-rate bond or note into a trust, which will issue two new certificates — a floating rate certificate and a residual certificate.

The floating rate certificate will have a tender option, through a liquidity facility that is typically issued by the program's sponsor or an affiliate that shortens the maturity of the bond or note so it becomes eligible to be purchased by a tax-exempt money market fund.

Alternative TOB structures have been formulated, and Merrill Lynch, Pierce, Fenner & Smith executed the first Volcker-compliant TOB transaction in June last year. Due to aspects of the rule already in place, no TOBs can be created using the traditional structure.

"TOBs represent about 25% of muni [closed-end fund] leverage, through investments in residual certificates," Moody's said. "As a result of the extension, CEFs will be able to continue using existing TOB structures for financing, and can avoid replacing that leverage, most likely at a higher cost."

"Without the delay announced last month, TOB trusts with up to $75 billion in floating rate certificates and $90 billion in underlying assets would have been unwound during the first half of 2015. Market participants project approximately $300 billion in long-term, tax-exempt new issues for all of 2015," Moody's continued. "Liquidation of up to $90 billion in bonds currently held in TOB trusts during the first half of the year would represent 60% of the $150 billion of new issuance expected in the same period. Postponement of that liquidation relieves pressure on the overall market."

Mike Nicholas, chief executive officer of the Bond Dealers of America, said the delay is a positive for the whole muni market although BDA continues to cast a wary eye at the rule.

"The delay in unwinding tender option bonds simply gives banks more time and flexibility which will help prevent a sharp pricing event in the muni market – good for all muni market participants," he said. “However, the BDA continues to be concerned with the Volcker Rule’s negative impact on overall credit market liquidity and the rule’s negative impact on investors.”

THE BOND BUYER

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